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DIRECTORATE OF
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Intelligence Memorandum

Trends in Soviet-Japanese Trade

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CENTRAL INTELLIGENCE AGENCY

Directorate of Intelligence

May 1972

INTELLIGENCE MEMORANDUM

TRENDS IN SOVIET-JAPANESE TRADE

Introduction

1. Japan became the Soviet Union's leading non-Communist trading partner in 1970. Further substantial growth in trade is indicated by the recently concluded Soviet-Japanese trade agreements for the period until 1975. At the same time, discussions are continuing on a number of cooperative ventures for development of raw materials and fuels in Siberia which go beyond the scope and period of the trade agreement.

2. This memorandum reviews Soviet-Japanese trade in the period 1966-70 and discusses the outlook for future trade and economic cooperation.

Discussion

Background

3. Soviet-Japanese trade grew at an average annual rate of 15% during the period 1966-70, well above the rate of increase in Soviet trade with the other developed Western countries. Increases in Japanese-Soviet trade during 1966 and 1970 have been outpaced by Japan's total world trade, which grew by more than 17% annually during this period. The growth in Soviet-Japanese trade resulted primarily from a significant rise in Soviet exports to Japan -- from US \$239 million in 1966 to \$379 million in 1970. Japan's share of Soviet trade was about 3% in 1970; similarly, the USSR accounted for only 2% of Japan's trade.

4. The volume of Soviet trade with Japan in 1966-70 was considerably in excess of that planned. Two-way trade during the five-year period initially was projected at about \$2.1 billion, and cumulative Soviet

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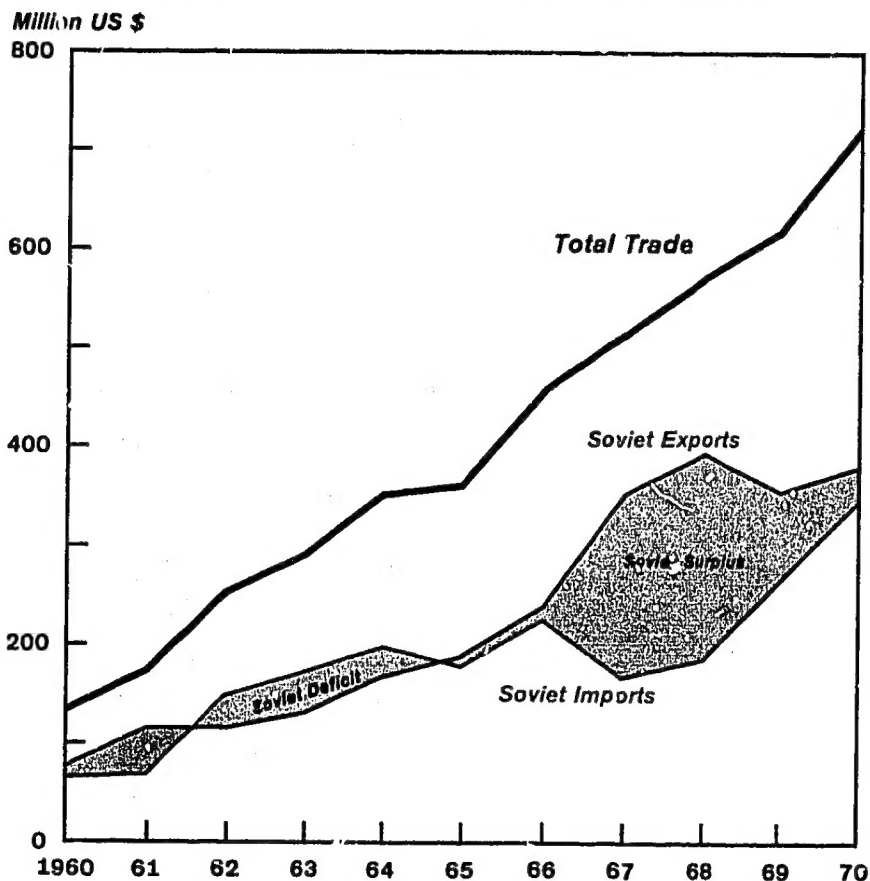
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imports were expected to exceed exports by about \$100 million. In fact, however, Soviet exports grew much more rapidly than anticipated, reaching \$1.7 billion for the period, more than \$500 million in excess of imports (see the graph). Two-way trade for the period was valued at \$2.9 billion.

Development of Soviet-Japanese Trade*



*From official Soviet trade data.

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A booming Japanese economy led to large increases of Soviet raw materials exports, particularly wood and wood products. Order backlogs, tight credit, and strong demand for Japanese goods in Western markets, however, limited the responsiveness of Japanese exporters to Soviet import requirements, particularly in the period 1966-68. As a result, the USSR registered a trade surplus which peaked in 1968 at \$206 million. A surplus was maintained in 1969 and 1970, but its magnitude diminished as the USSR increased imports of Japanese machinery and consumer goods.

5. About two-thirds of the increase in Japanese imports during 1966-70 consisted of wood and wood products (especially saw logs), which rose from \$58 million in 1966 to \$150 million in 1970 (see Table 1). Japanese importers, especially in 1967 and 1968, cultivated Soviet sources in anticipation of possible future US and Canadian supply limitations. The

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Table 1
Major Soviet Exports to Japan ^{a/}

	1966		1967		1968		1969		1970	
	Million US \$	Percent	Million US \$	Percent	Million US \$	Percent	Million US \$	Percent	Million US \$	Percent
Total	239	100	353	100	391	100	357	100	379	100
Coal and coke	18	8	27	8	31	8	36	10	35	9
Oil	42	18	37	10	34	9	25	7	33	9
Pig iron	38	16	40	11	26	7	16	4	16	4
Non-ferrous metals ^{b/}	9	4	23	7	15	4	19	5	13	3
Platinum and platinum group metals ^{c/}	23	10	31	9	50	13	42	12	40	11
Wood and wood products	58	24	95	27	134	34	127	36	150	40
Of which:										
Saw logs	39	16	69	20	108	28	103	29	127	34
Cotton fiber	18	8	41	12	55	14	35	10	18	5
Other and unspecified	33	14	58	16	45	12	56	16	73	19

a. Unless otherwise noted, data are from Soviet sources. Because of rounding, components may not add to the totals shown.

b. Excluding platinum and platinum group metals.

c. Data are from Western sources, with the 1970 value estimated.

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Soviet wood supplies, bolstered by a curtailment of Soviet timber sales to the People's Republic of China in 1967, also increased, although Siberian port facilities soon became a critical constraint. When expected US restrictions failed to materialize and domestic Japanese demand for wood products declined, the Japanese timber market became glutted. Although there were cutbacks in Japanese orders in 1969, Japanese wood imports from the USSR continued to rise on the basis of long-term contracts under a forestry cooperation agreement signed in 1968, when the Japanese were still anxious to develop Soviet timber sources (see the Appendix).

6. Soviet oil exports to Japan declined between 1966 and 1970 as increases in shipping costs associated with the closing of the Suez canal limited Soviet supply capabilities. The USSR exported 2.7 million metric tons of crude oil and petroleum products to Japan in 1970, down from the pre-Suez (1966) level of 4.1 million tons. Cotton fiber became a major Soviet export commodity during this period, rising to \$55 million in 1968 -- more than one-half of Soviet exports of cotton to the West. Soviet supply limitations led to a sharp decline in exports to Japan in 1969 and 1970.

7. Japanese machinery and equipment accounted for 37% of total Soviet imports from Japan during 1966-70 (see Table 2). The 1966 trade agreement placed particular emphasis on increased Soviet imports of Japanese ships, providing for Soviet imports of \$260 million in ships during 1966-70. The purchase of these ships had been incorporated into the 1966-70 Soviet plan, and the USSR considered Japan a prime supplier of certain specialized ships (for example, icebreaker freighters and fish processing motherships) which were not available from East European shipyards at that time. However, major Japanese shipbuilders (who apparently were not fully consulted during the original negotiations) were operating at full capacity and were in no position to respond to Soviet import requirements. Earlier disagreements on financing were resolved by 1968, but by that time order backlogs would have largely precluded ship deliveries before 1970. As a result, contracts eventually were signed for only three ocean dredgers with a total value of approximately \$7 million. The Soviet-Japanese cooperative forestry project, however, resulted in some expansion of imports of Japanese machinery and equipment, particularly of trucks, bulldozers, and other equipment (see Table 3).

8. Japan has shared in increased Soviet imports of manufactured consumer goods from the West. These imports have more than tripled since 1966, reaching \$65 million in 1970, and were second in importance only to machinery and equipment. Increases in Soviet imports of readymade apparel led this rise, averaging \$35 million per year over the last four years. Soviet imports of Japanese textile materials also increased. Imports of wool yarn alone increased from a 1968 level of \$3 million to \$31 million in

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Table 2
Major Soviet Imports from Japan a/

	1966			1967			1968			1969			1970		
	Million US \$	Percent of Total		Million US \$	Percent of Total		Million US \$	Percent of Total		Million US \$	Percent of Total		Million US \$	Percent of Total	
Total imports	224	100		166	100		185	100		264	100		345	100	
Machinery and equipment	106	47		66	40		65	35		76	29		123	36	
Chemicals	18	8		15	9		14	8		30	11		33	10	
Ferrous metals	33	15		17	10		27	15		43	16		50	14	
Of which:															
Steel	2	1		Negl.	Negl.		9	5		16	6		26	8	
Pipe	29	13		15	9		16	9		24	9		21	6	
Textile raw materials	11	5		5	3		9	5		29	11		35	10	
Manufactured consumer goods	21	9		41	25		48	26		57	22		65	19	
Other and unspecified	36	16		22	13		22	12		29	11		40	12	

a. Because of rounding, components may not add to the totals shown.

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Table 3
Soviet Imports of Machinery and Equipment from Japan a/

Description	1966		1967		1968		1969		1970	
	Million US \$	Percent	Million US \$	Percent	Million US \$	Percent	Million US \$	Percent	Million US \$	Percent
Total	106	100	66	100	65	100	76	100	123	100
Chemical plant and equipment	21	20	24	36	24	35	21	28	18	15
Ships and marine equipment	60	56	5	8	5	8	9	12	13	10
Light industry equipment	8	7	15	23	8	12	8	11	3	2
Medical equipment	5	5	5	8	6	9	7	9	7	6
Bulldozers, timber-pulling equipment	N.A.	--	N.A.	--	N.A.	--	N.A.	--	28	23
Equipment for the production of compressors for household refrigerators	N.A.	--	N.A.	--	N.A.	--	4	5	18	15
Other	13	12	16	24	23	35	26	34	37	30

a. Because of rounding, components may not add to the totals shown.

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1970. Other Soviet import categories showing large increases during 1966-70 included steel - from \$2 million in 1966 to \$26 million in 1970 - and chemical products - from \$18 million to \$33 million.

Problems in Soviet-Japanese Trade

9. Although Soviet-Japanese trade grew impressively, it continued to be hobbled by a variety of constraints. One of these is the low Japanese demand for Soviet manufactured goods. The Soviets attempted to take advantage of the Japanese desire to improve economic relations with the USSR by making Japanese purchases of Soviet machinery and other manufactures conditions for Soviet imports of Japanese machinery and equipment and chemicals. This sort of barter trade, which at times represented up to 30% of the value of Japanese export contracts, often resulted in obtaining unsalable goods and reduced the attractiveness of trading.

10. The growth of Soviet-Japanese trade was also affected by the limited Japanese success in expanding machinery and equipment exports to the USSR. Japan enjoys a significant competitive advantage for many types of machinery in Asian and Far Eastern markets, but Soviet imports of machinery and equipment are largely for use in Western regions of the USSR. In addition, Soviet requirements to import machinery and equipment have included few of the products for which Japanese competitiveness is strong (for example, electronics). Soviet requirements for Western equipment have been largely satisfied by West European countries which have had a long trading relationship with the USSR. Many West European governments, moreover, have actively promoted such trade through the use of generous government-guaranteed credits at subsidized rates and of large interbank credit lines. Filled orderbooks and full-capacity operation, created in part by Japanese success in expanding their exports to major Western markets, further limited both the ability and desire of many Japanese exporters to respond to Soviet import requirements for machinery and equipment.

11. Japanese exporters - already at a disadvantage because of their relative unfamiliarity with the Soviet market - could not offer the credit incentives necessary to improve their competitiveness during most of this period. Those firms which attempted to exploit the Soviet market often were frustrated by restrictive Japanese credit policies, particularly during 1966-69. Government guarantees covering export credits to any developed nation (including the USSR) are confined by Japanese law to the "supplier credit" system. Under this arrangement, the Japanese exporter bears the responsibility of obtaining the required credits from either the Japanese Export-Import Bank or private sources. Furthermore, to qualify for a

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government guarantee, the exporter must set credit terms which are acceptable to the government, and these may differ significantly from terms the USSR is willing to accept. K.S. Sangyo Co., for example, was forced to make up the difference between the interest rate acceptable to the USSR (5.8%) and the then minimum (6%) established by the Japanese government before the firm could conclude the 1968 forestry development agreement. Official interest and debt length restrictions have been gradually lowered to a point where individual Japanese firms are no longer deterred by having to make such costly supplemental arrangements in order to offer competitive financing. This in turn may partly explain the upsurge in Soviet orders for Japanese plant and equipment since late 1970.⁽¹⁾

12. The USSR, however, still objects to "supplier credit" for financing Siberian joint ventures. The "supplier credit" arrangement for financing a cooperative venture ties all Soviet purchases of Japanese goods under the agreement to the firm or consortium which has exclusive rights to this particular venture. In effect, this method puts the Japanese firms in a monopoly position. This procedure was followed in 1968 when the USSR obtained a \$133 million line of credit from a Japanese consortium of 14 firms for the development of Siberian forestry reserves. The Japanese firms planned to raise the prices of the machinery and equipment to be provided under the agreement to offset their costs in extending credit, whereas the USSR was seeking to pay only normal competitive prices.

13. Furthermore, it is difficult for private firms under the "supplier credit" arrangement to obtain the large blocks of credit that would be required for very large cooperative ventures, such as the Tyumen' oil pipeline (see the Appendix). For all these reasons the USSR has pressed for the extension of "buyer's credits" to cover proposed Siberian development projects. Such credits are issued directly to the foreign buyer (either by financial institutions with government guarantee or by the government itself), allowing him to choose his supplier and thus maximize the value of the loan. However, these credits are at present restricted to less developed countries.

14. The importance of current Japanese credit restrictions with respect to financing cooperative ventures was reflected in Soviet Foreign Minister Gromyko's request during his January 1972 visit to Tokyo that the Japanese Government provide financial backing for the much-discussed Tyumen' oil pipeline project, either directly through Export-Import Bank loans or government guarantees for funds advanced through private Japanese

1. Soviet orders for Japanese plant and equipment during 1970 amounted to at least \$165 million, placed chiefly at the end of the year. This high level of orders has continued to date.

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financial circles. The Japanese Ministry of International Trade and Industry announced in September 1971 that it intended to introduce a bill that would provide government guarantees for financial institutions offering "buyer's credits" for the development of resources, wherever located, for use in Japan - that is, Siberian oil, coal, and natural gas.⁽²⁾

Prospects for Soviet-Japanese Trade, 1971-75

15. Tentative trade targets set at the September 1971 signing of the 1971-75 trade and payments agreement reflect the shift in the pattern of Soviet-Japanese trade beginning in 1969, when Soviet exports declined while Soviet imports from Japan rose significantly. Total two-way trade during this period is scheduled to reach \$5.2 billion (see Table 4), representing a projected 12% average annual increase. Soviet exports during the period are forecast at \$2.4 billion and imports in excess of \$2.7 billion. The resulting Soviet deficit of approximately \$300 million contrasts with the \$535 million surplus realized by the USSR over the previous five-year period. The projected shift in the Soviet balance-of-trade position stems from large planned increases in Soviet imports of Japanese machinery and equipment as well as the slower growth expected in Soviet raw material exports to Japan. In marked contrast to the earlier agreement, there was no mention of Japanese ship exports as part of the 1971-75 agreement. The USSR evidently has placed ship orders with other suppliers - East Germany, Poland, Finland, Sweden, and Yugoslavia. France also obtained a Soviet order for about \$100 million.

16. The importance of machinery and equipment in Soviet imports from Japan should increase during the 1971-75 period. More than \$350 million in orders for machinery and equipment were placed by the USSR during 1970 and 1971 alone, led by orders for chemical and petrochemical equipment (\$183 million) and trucks, bulldozers, and related construction equipment (\$58 million). An additional \$115 million to \$135 million in Soviet orders for machinery and equipment should soon be forthcoming as part of the Soviet-Japanese cooperative ventures in port development and wood chip processing. In addition, Japanese exports of equipment and pipe may grow significantly in this period if the Tyumen' oil agreement should be concluded. Soviet imports of Japanese chemicals and consumer goods probably will continue to increase over the period. Soviet and Japanese officials expect a particularly rapid growth in Soviet imports of textiles and textile raw materials.

2. The Japanese have heretofore managed to expand their raw material sources (for example, Canada and Australia) with very little use of domestic capital. Japan has recently had large annual balance-of-payment surpluses, however, lessening its need to control the capital outflows which would be required to finance the proposed cooperative ventures in Siberia.

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Table 4
Prospects and Performance Under Soviet-Japanese
Trade and Payments Agreements a/

	Projected Level of Trade Under the 1966-70 Trade Agreement		1966-70 Performance		Projected Level of Trade Under the 1971-75 Trade Agreement	
	Cumulative Total (Million US \$)	Average Annual Increase (Percent)	Cumulative Total (Million US \$)	Average Annual Increase (Percent)	Cumulative Total (Million US \$)	Average Annual Increase (Percent)
Total trade	2,100	7	2,903	15	5,200	12
Soviet exports to Japan	1,000	3	1,719	15	2,400	8
Soviet imports from Japan	1,100	8	1,184	14	2,700	15
Soviet balance of trade	-100		+535		-300	

a. Because of rounding, components may not add to the totals shown.

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17. The growth of Soviet exports to Japan during the five-year period will be restrained by the limited ability of the USSR to increase its supply of those raw materials desired by the Japanese. The exception is saw logs; the USSR has the capacity to increase the level of exports to Japan but actual expansion probably will be limited by a continued leveling off in Japanese demand. Both the USSR and Japan recognized the Soviet limitations and forecast an 8% average annual growth rate for Soviet exports to Japan for the 1971-75 period, compared with 15% in 1966-70. Siberian reserves of crude oil, natural gas, coal, timber, and copper constitute a considerable base for future Soviet exports. But with the exception of the forestry industry, the USSR has not developed these reserves sufficiently for a substantial expansion of exports to Japan in the 1971-75 period.⁽³⁾ The construction of port facilities at Wrangel Bay (with the first phase scheduled for completion by the end of 1973) and the concomitant joint USSR-Japanese development of Soviet wood ship processing facilities should significantly increase Soviet wood chip exports, particularly during the latter part of the period.

18. Although the targeted growth rates for Soviet-Japanese trade for 1971-75 are not dependent upon further joint cooperative agreements, the long-run growth of Soviet-Japanese trade will depend in part on the development of Siberian raw materials resources for use by Japanese industry. Conflicting national priorities of the USSR and Japan have limited Soviet-Japanese economic cooperation, although three joint development agreements have been signed since annual discussions on the development of Siberia began in 1966. Until recently, relatively low priorities have been assigned by the USSR to the development of raw material deposits in Siberia, and little investment capital has been made available.

19. The USSR has proposed that foreign financing of some Siberian investment cover the total development cost, not just the cost of capital goods and equipment, contending that the foreign investor receives the full benefit of any development project through the subsequent availability of Soviet raw materials. Prospective Japanese investors, however, view Siberia as only one of several areas containing deposits of the raw materials required by Japanese industry, and they compare Soviet proposals with other similar proposals. The Japanese private sector has been reluctant to channel large amounts of capital into Siberian development projects which do not allow for foreign equity and/or controls. Facing little foreign competition for development of many of the proposed Siberian resource projects (for

3. The USSR has recently begun construction of a railroad which will eventually link the Takutsk coal deposits with the Trans-Siberian railroad. The first segment, scheduled for completion by 1975, will cover 110 of the 270 miles separating the coalfields from the main Trans-Siberian line.

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examples, petroleum and coal), the Japanese can afford to postpone investment until Soviet terms become more generous or until the needs of the Japanese economy cannot be satisfied by alternative sources of supply.

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22. In 1970, Japan became the leading non-Communist trading partner of the USSR, as it also was of Mainland China. This is a logical, if somewhat delayed, result of clearcut comparative advantages arising from Japan's manufacturing efficiency, the USSR's large raw material reserves, and the proximity of the two countries. Barring an unforeseen political disruption, trade between the two will continue to grow briskly.

23. Soviet trade with Japan grew at an average annual rate of 15% in the 1966-70 period. In 1970, total trade between the two nations rose to \$725 million. The period was characterized by a rapid growth in Soviet exports of those primary goods needed by an expanding Japanese economy. Soviet imports from Japan fell below the planned level for 1966-68 as a result, in part, of the inability of Japanese shipbuilders -- whose orderbooks were already filled -- to reach agreement with the USSR for the projected delivery of 92 ships. Soviet imports from Japan rose significantly in 1969-70, however, when Japanese ability to fulfill Soviet requirements for machinery and equipment improved.

24. The 1971-75 trade agreement recently signed by the Soviet Union and Japan forecasts a total trade for this period of \$5.2 billion. Annual growth is projected at 12%, a rate which is not likely to be fulfilled. The USSR has enjoyed six consecutive years of trade surpluses with Japan, but under the new agreement would incur deficits beginning in 1972 because Soviet imports are expected to continue to grow more rapidly than exports. Japanese machinery and equipment will account for the major portion of the rise in Soviet imports, but a significant growth in imports of textiles and textile fibers is also expected. Soviet exports to Japan during the next five years will continue to consist primarily of raw materials and semimanufactures -- for example, petroleum, coal, and wood and wood products -- but the growth in most of these exports will be limited by supply constraints.

25. Three cooperative agreements for developments in Siberia -- timber, wood chips, and Wrangel Bay port -- have been signed by Japan and the USSR since talks began in 1966. Japanese credit restrictions have been an important factor in the failure to reach further agreements. Although the Japanese Government has relaxed restrictions on the interest rates and debt length of those credits which Japanese exporters may offer to the USSR, the amount of capital available remains limited by government regulations. The importance the USSR attaches to the removal of such credit restrictions was highlighted by Soviet Foreign Minister Gromyko's recent insistence on Japanese Government backing of Siberian development either through Export-Import Bank loans or via broadened government credit guarantees.

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26. The targeted growth rates for trade during 1971-75 are not dependent on further joint cooperative projects. However, the longer run growth of trade is likely to depend to a considerable extent on the cooperative development of Siberian raw materials for use by Japanese industry. Negotiation on the largest of these cooperative projects, the Tyumen' oil pipeline, continues, but Japanese reservations, both political and economic, indicate that agreement is not imminent. Agreements on proposed joint development of Siberian copper and coal are not likely in 1971-75, but an agreement for the development of Sakhalin and East Siberian natural gas may be concluded. The prospects for Japanese involvement in Soviet development schemes in Siberia will be improved if Moscow and Tokyo are able to resolve the status of the Northern Territories dispute during peace treaty negotiations later this year.

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